TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 97-45

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Determination of status as manufacturer with respect to commercial construction projects.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

> (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
> (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
> (C) The applicable law must not have been changed or amended;
> (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and

(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is a wholly owned subsidiary of [CORPORATION A]. The Taxpayer is located in [CITY], Tennessee. [CORPORATION A] is in the business of designing, engineering, procurement of materials, fabrication and assembly, and sometimes installation of curtain walls, windows, and entrances for commercial construction projects.

The design and engineering activities consist of drawings, calculations, and materials take-offs primarily for the manufacture of the work. The Taxpayer orders the components from various manufacturers. The materials used, including aluminum, glass, insulation, steel, and stone, are prepared for fabrication into complete units ready for installation. The fabrication and assembly generally consist of receiving, fabricating, assembly, glazing, and packing of the materials for delivery to construction sites outside of Tennessee.

Some projects also involve field installation of the fabricated or assembled material at the construction site. Installation is more commonly performed for domestic rather than international projects. Other projects involve the purchase of the assembled units from the Taxpayer without installation services.

Most of the engineering, material procurement, and fabrication or assembly will occur in the Taxpayer's Tennessee facility. The actual materials will be sourced throughout the world. The costs of various parts of construction projects for 1997 are as follows:

Engineering	10%
Materials and Other Purchases	50%
Fabrication and Assembly	11%
Field Installation (including labor, tools & equipment, but not including any of the above)	29%

The majority of the cost of a project which includes installation, then, is the cost of the engineering, materials, and fabrication, rather than installation.

Taking into account the cost of materials in an installation contract, the percentage of total revenue from installation contracts, as opposed to sales contracts, varies between 30-70%. Because of the nature of the business, the Taxpayer cannot predict what percentage of gross revenue will come from installation contracts in any given year.

ISSUES

1. Whether the Taxpayer is a manufacturer for purposes of the industrial machinery exemption in Tenn. Code Ann. § 67-6-206.

2. Whether, if [CORPORATION A] establishes a separate company to perform installation, the Taxpayer would then be deemed a manufacturer.

RULINGS

1. The Taxpayer does not qualify as a manufacturer for the purposes of the industrial machinery exemption.

2. If the Taxpayer sold the fabricated materials to a separate company performing installation, the Taxpayer would be considered a manufacturer provided that all other requirements are met.

ANALYSIS

The industrial machinery authorization is granted to entities whose principal business is the fabrication or processing of tangible personal property for resale and consumption off the premises. Tenn. Code Ann. § 67-6-102(12)(A). An activity is the principal business if revenues generated from that activity constitute more than 50% of the total revenues generated at the specific location. *Tennessee Farmers' Coop. v. State*, 726 S.W. 2d 87 (Tenn. 1987).

Generally, exemptions from taxation are only allowed when the statute grants the exemption in clear and unmistakable terms. All doubts must be resolved against the exemption, and statutes that confer exemptions are to be strictly construed against the taxpayer. *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W. 2d 132 (Tenn. 1992).

The Taxpayer will be deemed a manufacturer if its principal business is the fabrication or processing of tangible personal property for resale. Provided that more than 50% of revenues generated result from the sale of tangible personal property fabricated or processed by the Taxpayer, the remaining activities are immaterial.

1. The Taxpayer designs and purchases component parts of the curtain walls and other units, then assembles the parts into a unit ready for installation. If the Taxpayer performed no installation and only manufactured the units, clearly the Taxpayer would be deemed a manufacturer and would qualify for an industrial machinery number and all associated tax benefits.

The fact that the Taxpayer performs some installation of its products does not prevent it from being deemed a manufacturer assuming all other requirements are met, in particular, that revenues are derived primarily from sales contracts as opposed to installation contracts.

As set forth in the facts above, predicted revenue for the upcoming fiscal year includes approximately 29% from installation. This breakdown of revenue, however, does not associate any product revenues with the installation revenue. Revenue from installation contracts, including the charges for the units, constitute anywhere between 30-70% of annual revenue. Sales contract revenue would correspondingly fluctuate between 30-70% of revenue.

The comparison for purposes of determining the primary source of revenue is not a percentage breakdown of total revenue, which necessarily involves a lesser installation component in light of the total costs for engineering, materials, and fabrication. The relevant comparison is between revenue generated from installation contracts to revenue generated from sales contracts. Based on the facts provided, the Taxpayer has not demonstrated sufficiently that revenue from sales contracts constitutes more than 50% of total revenue or will consistently do so in the future. Accordingly, the Taxpayer does not qualify as a manufacturer for the purposes of the industrial machinery exemption.

2. If [CORPORATION A] established a separate company to perform installation services, the Taxpayer's primary source of revenue would clearly result from the sale of tangible personal property and the Taxpayer would be entitled to the industrial machinery exemption.

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Caroline R. Krivacka
Tax Counsel

APPROVED: __________________________
Ruth E. Johnson
Commissioner

DATE: 10-29-97